

REPORT TO THE STOCKHOLDERS

Colonial Stores Incorporated



YEAR ENDED DECEMBER 30, 1944

Norfolk, Virginia,
March 14, 1945.

To the Stockholders of

COLONIAL STORES INCORPORATED:

This is the fifth annual report of your Company since the merger in 1940 of Southern Grocery Stores Incorporated into David Pender Grocery Company, forming Colonial Stores Incorporated. The financial condition of the Company as at December 30, 1944 and operating results for the fiscal year ended on that date are set forth in the accompanying balance sheet and income account reported upon by Messrs. Peat, Marwick, Mitchell & Co., independent auditors.

OPERATIONS

Sales were \$97,656,627 for the fifty-two week period ended December 30, 1944. This was a gain of 7.4% over the fifty-three week fiscal year ended January 1, 1944. This record volume is more than double that of the constituent companies during 1940.

Net income was \$793,895, including \$180,000 estimated post-war tax refund. After dividend payments on the 5% cumulative preferred stock, series A, there remained a balance of earnings equivalent to \$2.63 per share of common stock outstanding at the end of the year.

The following is a condensed statement covering operations for the last two years:

	1944 (52 Weeks)	1943 (53 Weeks)
Sales	\$97,656,627	\$90,900,794
Net profit before depreciation	3,334,791	2,873,393
Appropriation for depreciation and amortization	438,399	467,539
Profit or Loss on disposal of capital assets	5,497	244,273
Balance	2,890,895	2,161,581
Estimated federal and state taxes on income	2,097,000	1,443,000
Net income	\$ 793,895	\$ 718,581
Net income per \$1.00 of sales	0.8c	0.8c
Net income per share:		
Preferred stock	\$ 14.81	\$ 13.19
Common stock	2.63	2.37
Federal and state income taxes per share of common stock	\$ 8.38	5.88

Regular quarterly dividends of 62½c per share, aggregating \$2.50, were paid on the preferred stock. Four quarterly dividend payments were made upon the common stock, 25c per share on March 1st and June 1st and at the increased rate of 31¼c per share on September 1st and December 1st. Total dividends on the common stock in 1944 were \$1.12½ per share compared with \$1.00 per share in 1943.

Taxes upon income continued to increase, absorbing 72.5% of net income in 1944 compared with 66.7% in the preceding year. This increase was due in part to higher federal excess profits tax rates and in part to a saving in 1943 taxes of approximately \$208,000 by reason of a loss of \$244,273 on the sale of land and buildings.

Last year the filing of claims for refund of excess profits taxes under Section 722 of the Internal Revenue Code was reported. An additional claim will be filed covering 1944 operations. It is impossible to anticipate the benefits, if any, which may be derived from these claims.

Although wages, supplies and general operating expenses have increased, the percentage of operating costs per dollar of sales has declined, due principally to greater sales volume. Maintenance costs increased mainly because of the continued use of over-age equipment, for which no replacements were available, and from the excessive wear on all types of mechanical equipment, especially motor trucks, as a result of their operation by inexperienced employees.

Sales volume has been affected not only by rationing regulations but more particularly by curtailed supplies of food for civilian consumption resulting from Government purchases for the armed forces and for other purposes. No improvement can be expected before the European phase of the war is concluded.

From the 1943 appropriation under the sinking fund provisions of the 5% cumulative preferred stock, series A, 873 shares of the stock were retired at a cost of \$43,708.43, an average

price of \$50.07 per share. To the remaining balance in the fund there has been added \$58,779 (based upon the earnings for the year 1944), making a total of \$58,806.55 available for the retirement of preferred stock in 1945. Since the preferred stock was issued in 1940, a total of 2404 shares have been retired through operation of the sinking fund.

On September 30th, 1944, \$165,000 principal amount of the 3½% debenture bonds were retired through operation of the debenture sinking fund, raising the total principal amount of bonds retired to \$320,000. The sinking fund installment due September 30, 1945, in the amount of \$165,000 is included as a current liability in the balance sheet.

Payments, authorized under the incentive compensation plan, to all full-time employees were \$361,251, which included \$153,132 paid to the principal executives.

FINANCIAL

Principal changes in the Company's financial condition during 1944 are reflected in the following statements:

	At End of Fiscal Year		
	1944	1943	Increase or Decrease
CURRENT ASSETS:			
Cash	\$ 4,103,816	\$ 1,994,897	\$2,108,919
Accounts receivable, less reserves	191,779	363,269	171,490
Inventories	6,175,740	6,894,199	718,459
Total current assets	10,471,335	9,252,365	1,218,970
CURRENT LIABILITIES:			
Accounts payable	1,561,515	1,455,124	106,391
Accrued liabilities	447,488	401,503	45,985
Reserve for taxes upon income, less U. S. Treasury Tax Notes	2,362,229	1,563,483	798,746
Sinking fund payment for debt retirement due within one year	165,000	165,000	—
Total current liabilities	4,536,232	3,585,110	951,122
Net working capital	\$ 5,935,103	\$ 5,667,255	\$ 267,848
OTHER ASSETS:			
Investments	\$ 137,372	\$ 129,751	\$ 7,621
Post-war tax refund	381,803	201,803	180,000
Fixed assets, less depreciation	1,970,643	2,203,986	233,343
Prepaid and deferred charges	444,499	422,032	22,467
Goodwill	2	2	—
Total assets, less current liabilities *	\$ 8,869,422	\$ 8,624,829	\$ 244,593
* REPRESENTED BY:			
Long term debt, less current sinking fund installment	2,315,000	2,480,000	165,000
Reserves	26,118	23,036	3,082
Capital stock and surplus, less preferred sinking fund	6,528,304	6,121,793	406,511
TOTAL	\$ 8,869,422	\$ 8,624,829	\$ 244,593

Working capital increased \$267,848 while the ratio of current assets to current liabilities shows a slight decline from 2.58 to 1 at the end of 1943 to 2.31 to 1. This decline in the ratio is due entirely to the increase in current liabilities, consisting largely of an increase in tax reserves. The large increase in cash balances reflects reduced accounts receivable, a substantial decrease in merchandise inventories, increased current liabilities and the excess of depreciation reserves over capital expenditures.

The \$798,746 increase in reserves for income taxes is net after application of \$300,000 United States Treasury Tax Notes, Series C. Tax reserves also include \$371,380, the payment of which is deferred under tax regulations pending action on the Company's claim for relief.

The increase in investments is represented substantially by the increment in cash surrender value of life insurance.

Post-war tax refund increased \$180,000 (10% of the federal excess profits tax accrual for

1944) making a total of \$381,803, of which \$93,803 is represented by First Series Bonds.

The \$233,343 reduction in net fixed assets represents the excess of appropriations for depreciation over capital expenditures.

After payment of all dividends there remained a balance of \$382,109 (including the post-war refund) which was added to earned surplus, increasing the total to \$2,560,620.

The common stock capital of the company was increased by 4893 shares issued at \$17.00 per share for a total of \$83,181. The \$58,716 excess of the issue price over the \$5.00 par value per share was credited to capital surplus.

WARRANTS ON PREFERRED STOCK

Each share of 5% cumulative preferred stock, series A, as originally issued, carried with it a non-detachable purchase warrant currently entitling the holder to purchase one share of common stock of the Company on or before December 1, 1945 at \$17.00 per share; thereafter and to December 1, 1947 at \$19.00 per share when the warrant expires.

Holders of 4893 shares of the preferred stock exercised their warrants and purchased an equivalent number of shares of the common stock at the price of \$17.00 per share. Since the close of the fiscal year 7433 warrants have been exercised, bringing the total of common stock so issued to 12,326 shares as of the date of this report. For about a year the quoted market price of the common stock has been consistently higher than the current price provided in the stock purchase warrants.

PROPERTIES

Development of new stores and facilities has been of necessity deferred.

In April the original Pender Department Food Store was converted into a modern super-market, becoming the 74th Big Star Store. This marked the passing of a Norfolk landmark and with it the outmoded credit and delivery services which could not survive manpower shortages and wartime restrictions on prices, tires and delivery equipment.

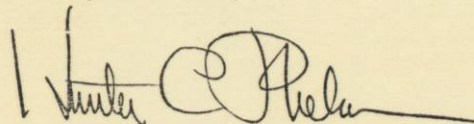
Three Little Star stores, permitted under government building restrictions to meet a demonstrated necessity, were added and ten conventional stores were discontinued. Otherwise capital expenditures were limited to the ordinary additions and replacements for which materials were available. A total of 433 stores were in operation at the end of the year.

CONCLUSION

Large self-service stores and conventional stores have proved their permanent respective value in a well-balanced system of retail food distribution. The 82 Little Star self-service stores which had been developed under the conventional store department were transferred to the super-market department on January 1st, 1945, thereby centralizing control of the 156 self-service stores, leaving the 277 conventional stores under their original management. This internal refinement of the organization was dictated by operating experience and brings about a higher degree of specialization which will improve the operation of both types of stores. This was accomplished without change in personnel other than the transfer of supervisors and department heads and the promotion of a number of proven junior executives to positions of greater authority and responsibility.

Three years of operation under war conditions have been completed. A total of 1963 Colonials have joined the colors of whom 21 have made the supreme sacrifice. The fine example of these men and women is an inspiration to those remaining at home who have met mounting demands upon an already overburdened and under-manned organization cheerfully and courageously. To this splendid organization spirit is due much of the credit for the continued progress of your Company.

Respectfully submitted,



President.

Colonial Stores Incorporated

STATEMENT OF PROFIT AND LOSS FOR THE FISCAL YEAR ENDED DECEMBER 30, 1944

Net sales		\$ 97,656,626.50
Cost of goods sold, including certain occupancy and buying expenses	\$ 81,429,273.57	
Selling, general and administrative expenses, exclusive of certain occupancy and buying expenses	12,806,417.54	
Provision for depreciation and amortization of property, plant and equipment	<u>438,399.43</u>	<u>94,674,090.54</u>
Operating Profit		2,982,535.96
Other Income:		
Gain on disposal of capital assets	4,363.12	
Miscellaneous	<u>1,134.00</u>	<u>5,497.12</u>
		2,988,033.08
Interest on Fifteen-Year Debentures (including amortization of debt expenses)		<u>97,138.10</u>
Net Income, before Provision for Income and Excess Profits Taxes		2,890,894.98
Provision for Income and Excess Profits Taxes (Estimated):		
Federal normal income tax and surtax	346,000.00	
Federal excess profits tax (less post-war refund \$180,000.00)	<u>1,621,000.00</u>	
	1,967,000.00	
State income taxes	<u>130,000.00</u>	<u>2,097,000.00</u>
Net Income, carried to Earned Surplus		\$ <u><u>793,894.98</u></u>

ASSETS

CURRENT ASSETS:

Cash in banks and on hand, less preferred stock sinking fund appropriation, \$58,806.55 \$ 4,103,816.24

Accounts Receivable:

Customers' accounts receivable	\$ 22,619.39	
Claims, allowances and other trade receivables	120,309.38	
Insurance claims and miscellaneous receivables	66,923.89	
	<u>209,852.66</u>	
Less reserve for doubtful accounts	18,073.67	191,778.99

Inventories (Note "1"):

Stores and markets	2,804,609.77	
Warehouses and bakeries	3,059,658.23	
Merchandise in transit	311,472.38	6,175,740.38

Total Current Assets		10,471,335.61
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SINKING FUND FOR RETIREMENT OF 5% CUMULATIVE PREFERRED STOCK, SERIES "A" (Note "2(c)")

58,806.55

POST-WAR REFUND OF FEDERAL EXCESS PROFITS TAXES (including \$93,803.17 first series bonds)

381,803.17

INVESTMENTS:

Cash surrender value of life insurance policies (face amount \$317,500.00)	127,394.82	
Investment in class "B" stock of National Food Products Corporation — affiliated company — at cost, less reserve, \$22,180.50 (quoted market value \$25,974.00)	7,992.00	
Miscellaneous — at cost, less reserve, \$511.93	<u>1,985.00</u>	137,371.82

PROPERTY, PLANT AND EQUIPMENT AT COST:

Land	32,733.78	
Buildings	86,241.79	
Fixtures and equipment	3,860,819.71	
Delivery equipment	397,477.53	
Improvements to leased premises	136,927.66	
	<u>4,514,200.47</u>	
Less reserves for depreciation and amortization	<u>2,543,557.91</u>	1,970,642.56

PREPAID EXPENSES AND DEFERRED CHARGES:

Insurance, taxes and licenses	142,817.10	
Supplies	273,495.93	
Unamortized debt expenses	21,744.36	
Miscellaneous	<u>6,441.97</u>	444,499.36

GOODWILL AND LEASEHOLDS — AT NOMINAL AMOUNT

2.00

\$13,464,461.07

(See notes on page 7)

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C SHEET

BER 30, 1944

LIABILITIES

CURRENT LIABILITIES:

Accounts payable — trade.....		\$ 1,561,515.37
Deductions from employees' compensation in respect of taxes.....		166,551.58

Accrued Liabilities:

Salaries and wages.....	\$ 125,924.63	
Taxes (other than taxes on income).....	131,783.12	
Interest	22,413.04	
Miscellaneous	815.58	280,936.37

Provision for taxes on income (Note "4(a)").....	2,662,229.19	
Less U. S. Treasury notes, tax series C.....	<u>300,000.00</u>	2,362,229.19

Liability for sinking fund installment (due September 30, 1945) on Fifteen-Year 3½% Sinking Fund Debentures.....		<u>165,000.00</u>
Total Current Liabilities.....		4,536,232.51

FIFTEEN-YEAR 3½% SINKING FUND DEBENTURES (payments due annually — balance, \$485,000.00 due October 1, 1956).....	2,480,000.00	
Less current installment due in 1945.....	<u>165,000.00</u>	2,315,000.00

RESERVES FOR SELF-INSURANCE OF MINOR RISKS.....		26,117.70
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CAPITAL STOCK AND SURPLUS:

CAPITAL STOCK (Note "2")

Preferred Stock of \$50.00 par value per share:

Authorized, 90,000 shares — issuable in series.

Outstanding, 53,596 shares 5% cumulative, series "A"

(48,703 shares with purchase warrants entitling holders

to purchase an equal number of shares of common stock) ..

2,679,800.00

Common stock of \$5.00 par value per share:

Authorized, 500,000 shares (60,703 shares reserved for
issuance upon exercise of options and purchase warrants
attached to preferred stock)

Outstanding, 250,074 shares.....

1,250,370.00

3,930,170.00

SURPLUS — per accompanying statement:

Capital surplus

\$ 96,320.65

Earned surplus (Notes "3" and "4").....

2,560,620.21

2,656,940.86

6,587,110.86

CONTINGENT LIABILITIES (Note "4")

\$13,464,461.07

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Colonial Stores Incorporated

BALANCE SHEET, Continued

Notes:

1. Inventories:

Inventories of merchandise in warehouses, bakeries and retail markets represent physical inventories priced at the lower of cost or market, cost being determined by the first-in, first-out method and market by current replacement cost. Stores inventories have been determined on the basis of centrally controlled perpetual inventory records of the retail selling value of merchandise at each store, less a percentage calculated to reduce such retail value to the lower of cost or market. The amounts shown by the perpetual inventory controls are substantiated by physical inventories at retail, taken periodically throughout the year. Merchandise in transit is stated at cost, which is not in excess of current replacement cost.

2. Capital Stock:

- (a) Holders of the 5% cumulative preferred stock, series "A", are entitled to preferences in liquidation or redemption in the following amounts together with, in each case, accrued unpaid dividends thereon: Voluntary liquidation or redemption, \$52.50 per share (aggregate \$2,813,790.00); involuntary liquidation, \$50.00 per share (aggregate \$2,679,800.00).
- (b) Of the outstanding 5% cumulative preferred stock, series "A", 48,703 shares carry a non-detachable purchase warrant entitling the holder to purchase one share of common stock of the company on or before December 1, 1945 at \$17.00 per share; thereafter on or before December 1, 1947 at \$19.00 per share.
- (c) There shall be set aside on or before April 1st of each year a sinking fund for the retirement of the 5% cumulative preferred stock, series "A", in an amount equal to 20% of net earnings in excess of \$500,000.00 for the preceding calendar year, but not more than \$120,000.00 in any one year.
- (d) Options have been granted to the president and the executive vice-president of the company entitling them to purchase an aggregate of 12,000 shares of common stock on terms similar to those set forth in the stock purchase warrants attached to the 5% cumulative preferred stock, series "A", as described in paragraph (b) above.

3. Surplus:

- (a) The terms of the indenture covering the Fifteen-Year 3½% Sinking Fund Debentures impose certain limitations upon the financial activities of the company, including restrictions as to the payment of dividends (other than stock dividends) or the purchase or retirement of its capital stock if such action would impair the specified ratios of current assets to current liabilities, working capital or undistributed earnings beyond stated limits; of the earned surplus at December 30, 1944, an amount of \$1,785,520.31 is thereby restricted.
- (b) The terms of issuance of the 5% cumulative preferred stock, series "A", provide that, so long as any of such stock remains outstanding, the company will not make any distribution to holders of the common stock in excess of net earnings after September 1, 1940 plus the sum of \$250,000.00.

4. Contingent Liabilities:

- (a) Federal income tax returns for the years 1941, 1942 and 1943 are presently under examination by the U. S. Treasury Department, and it is indicated that additional assessments will be levied for such years, principally as a result of a general downward revision in rates used by the company for depreciation of store fixtures and other equipment. The company intends to adjust its depreciation policy retroactively to conform to that proposed for Federal income tax purposes, upon completion of a study of the property and reserve accounts which is now in progress. It is presently indicated that, while this adjustment will result in a substantial credit to earned surplus, the effect thereof on income reported for the year 1944 (after providing for income taxes) will be relatively immaterial in amount. No information is available as to the amount of tax benefits, if any, which may ultimately be obtained through claims filed under the excess profits tax relief provision of the Internal Revenue Code.
- (b) Claims for damages and possible additional state and miscellaneous assessments — not considered to be significant in amount.

Colonial Stores Incorporated

STATEMENT OF SURPLUS FOR THE FISCAL YEAR ENDED DECEMBER 30, 1944

CAPITAL SURPLUS

Balance as of January 1, 1944.....		\$ 37,663.08
Add:		
Premium on 4,893 shares of common stock issued upon exercise of purchase warrants attached to preferred stock.....	\$ 58,716.00	
Less premium (net) paid on 873 shares of 5% cumulative preferred stock, series "A", retired through sinking fund.....	<u>58.43</u>	<u>58,657.57</u>
Balance as of December 30, 1944.....		\$ <u><u>96,320.65</u></u>

EARNED SURPLUS

Balance as of January 1, 1944.....		\$ 2,178,510.80
Net income for year.....		<u>793,894.98</u>
		2,972,405.78
Cash dividends paid:		
5% cumulative preferred stock, series "A"— \$2.50 per share.....	\$ 134,535.63	
Common stock — \$1.125 per share.....	<u>277,249.94</u>	<u>411,785.57</u>
Balance as of December 30, 1944.....		\$ <u><u>2,560,620.21</u></u>

ACCOUNTANTS' REPORT

To the Board of Directors,
Colonial Stores Incorporated,
Norfolk, Virginia.

We have examined the balance sheet of Colonial Stores Incorporated as of December 30, 1944 and the statements of profit and loss and surplus for the fiscal year then ended, have reviewed the system of internal control and the accounting procedures of the company and, without making a detailed audit of the transactions, have examined or tested accounting records of the company and other supporting evidence, by methods and to the extent we deemed appropriate. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances and included all procedures which we considered necessary.

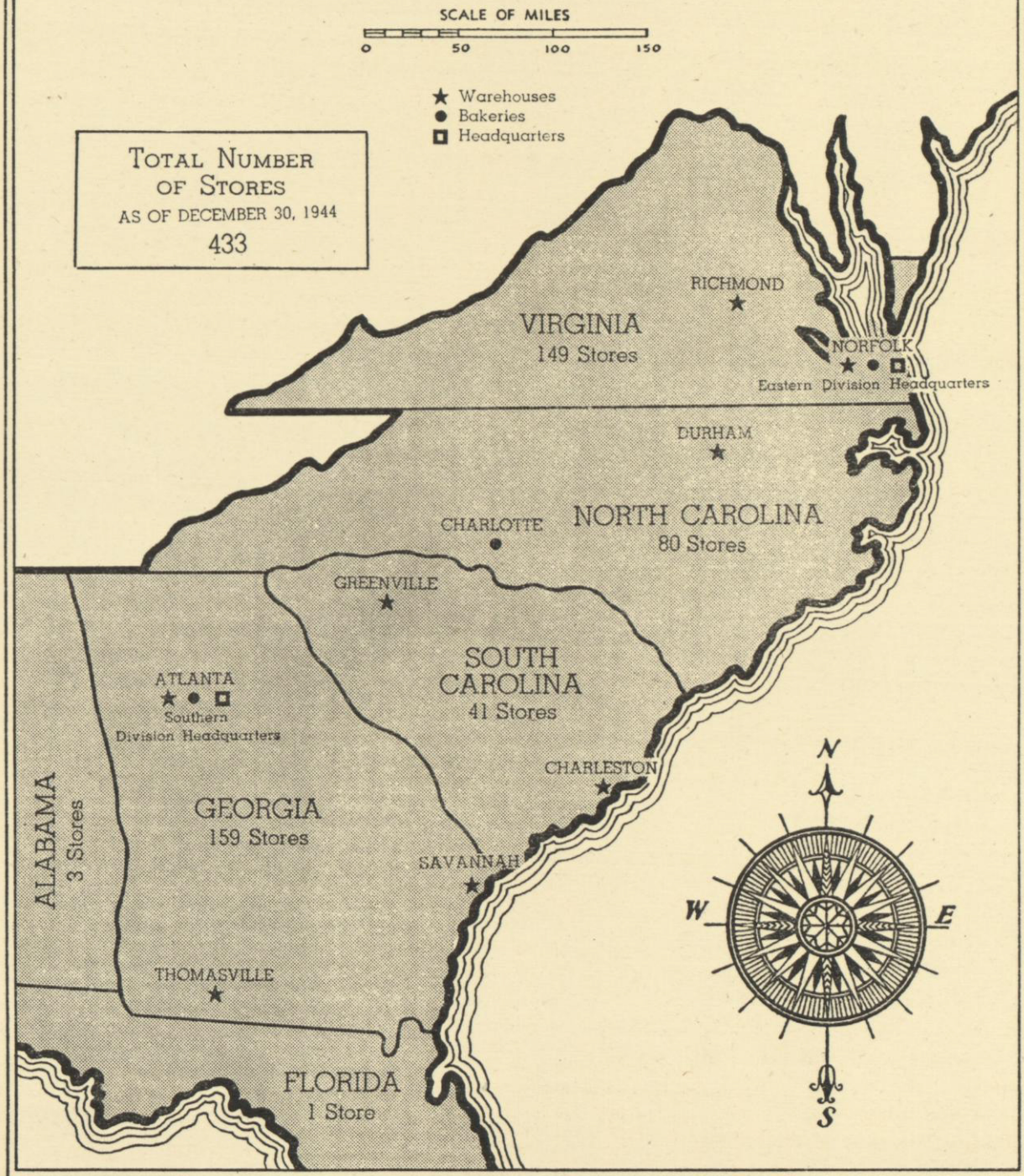
In our opinion, the accompanying balance sheet and related statements of profit and loss and surplus present fairly the position of Colonial Stores Incorporated at December 30, 1944 and the results of its operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

PEAT, MARWICK, MITCHELL & CO.

Atlanta, Georgia,
March 8, 1945.

Colonial Stores Incorporated

GEOGRAPHICAL DISTRIBUTION OF STORES



Colonial Stores Incorporated

301-323 DUNMORE STREET
NORFOLK, VIRGINIA

DIRECTORS

SCOTT W. ALLEN	W. C. PENDER
RYBURN G. CLAY	HUNTER C. PHELAN
JOHN M. FOSTER	ELLIS D. SLATER
ROBERT M. HANES	MARION SMITH
T. STOCKTON MATTHEWS	RUSSELL B. STEARNS
JANSEN NOYES	JOHN TWOHY, II
C. T. WILLIAMS, JR.	

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SCOTT W. ALLEN	Executive Vice-President
J. W. WOOD	Vice-President
JOSEPH SEITZ	Vice-President
W. C. PENDER	Secretary
R. B. JACKSON	Treasurer

AUDITORS

PEAT, MARWICK, MITCHELL & Co.

TRANSFER AGENT

BANKERS TRUST COMPANY, NEW YORK, N. Y.

REGISTRAR

CHEMICAL BANK AND TRUST COMPANY, NEW YORK, N. Y.